

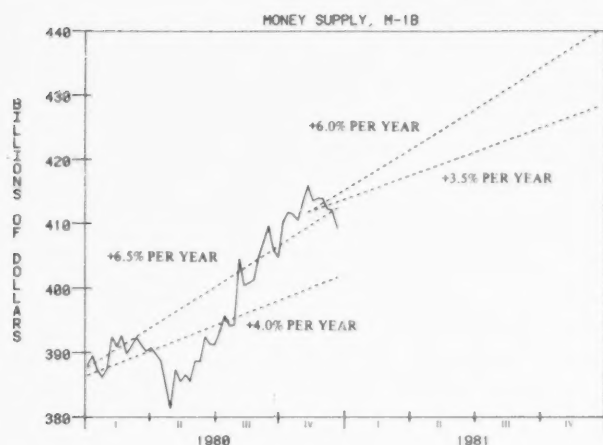
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The Manufacturers Hanover Financial Digest

Weekly Commentary,
Selected Financial Data,
and Business Indicators

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Room to Maneuver

If the chart above is any guide, the Federal Reserve has begun the new year with some room to maneuver, insofar as monetary policy is concerned. Not only did the money supply, M-1B, drop into the Fed's target range for 1980 at the end of last year—it begins the year 1981 at a level far below the lower limit of the Fed's target range for 1981.

This is because the base period for this year's target range is the average level of the money supply in 1980's fourth quarter, and the money supply has been declining, on balance, since the middle of November. It ended up the year 1980 at a level far below the average for the fourth quarter. Thus, even though the Federal Reserve's growth targets for 1981 call for slightly less growth in the money supply than in 1980, there is still room for expansion, near-term, before the Fed need worry about the money supply growing too rapidly once again.

The Fed will need all of the room to maneuver it can get. This is because the banking system on January 1 moved to nationwide negotiable order of withdrawal (NOW) accounts. While no one can tell for certain how the various monetary aggregates will be affected, it would seem reasonable to expect that M-1B might be bloated, since many people who now keep their liquid funds in savings and small-denomination time deposits (currently counted as M-2) may elect to move them into NOW accounts,

where they can obtain interest on their funds while still being able to access them relatively quickly. NOW and automatic transfer service accounts at banks and thrift institutions are counted by the Fed as part of M-1B.

Signs Of Softness . . .

Consumers and business alike are expecting tougher times ahead under the weight of a slowing economy, high rates of inflation and interest. This pessimism can be seen from a glance at two widely followed surveys—the Conference Board's index of consumer confidence and the monthly survey conducted by the National Association of Purchasing Management Inc., both of which worsened in December.

Consumer expectations dropped in December for the second month in a row, after climbing for five months. The December decline was sharp, as the index plummeted by 11 points—exceeded only last April when it posted its largest monthly drop ever. This change in consumer attitudes was reflected in the buying plans index, where intentions to buy an automobile or a major appliance fell by 9.2 points while plans to buy a home remained unchanged.

Not surprisingly, many businesses have begun to feel the pinch. In the survey of purchasing managers at 225 industrial companies, both production and new orders turned negative. More particularly, 22 per cent of those managers questioned reported lower production schedules, up from 13 per cent last month. Furthermore, only half of those who reported increased production in November did so again in December. Finally, more than twice as many managers posted a lower rate of incoming new orders than in November.

. . . Begin To Spread

Output is down because manufacturers' inventories expanded by \$1.3 billion in November. Many producers apparently rushed to increase production in response to the summer and early fall uptick in economic activity. Industrial production increased for four consecutive months beginning in August, totaling 5.7 per cent, while final demand remained relatively weak. This left producers with swollen



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stocks. The greatest increase took place in the food products industry where consumers, confronted with skyrocketing food costs and eroding purchasing power, altered their eating and shopping habits.

The value of manufacturers' shipments slowed to a 1.1 per cent rate of growth from 2.6 per cent a month earlier. Most of the slowdown was in the durable goods industries as shipments increased at one-quarter of October's pace. New orders, which indicate levels of future production increased by one per cent, boosted by a hefty 8.2 per cent increase in orders for transportation equipment, mostly from

the aircraft and parts industry. Although durable goods orders posted a 1.3 per cent rise, when the transportation equipment industry is excluded, it becomes a decline of 0.3 per cent.

The automobile industry ended last year mired in red ink. Domestic producers sold 20 per cent fewer cars in 1980 than during the year before. At 6.6 million units, 1980's sales were the lowest since 1961. Sales plummeted in December, ending with 5.6 million units sold at a seasonally adjusted annual rate in the final ten days—a 25.4 per cent decline from the comparable period in the year before. Although the automobile industry represents

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 12/31/80	% Change Since	
		Week Ago	Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies			
Owned Outright & RPs	126.445	- 1.641	- 1.395
Loans to Depository Inst.	1.627	- .022	+ .196
Float	9.176	+ 3.138	+ 1.494
Total Reserve Bank Credit	145.976	+ 1.803	+ 2.576
Treasury Deposits with			
Federal Reserve Banks	3.286	+ .999	- .321
Currency Outside Banks	123.285	+ .373	+ 9.239
Member Bank Reserves:			
Required	40.558	+ .529	- 3.659
Excess (Deficiency)	.590	- .219	+ .040
Total Reserves Held	41.148	+ .310	- 3.619
Net Borrowed Reserves	.921	+ .200	+ .104
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	92.963	+ 1.736	+ 15.154

Monetary Aggregate†

		% Change Since	
		Three Months Ago*	Year Ago
M-1A	381.4	+ 0.9%	+ 4.1%
M-1B	406.8	+ 3.1%	+ 6.3%
M-2 (November '80)	1,667.6	+ 9.8	+ 10.0
L (October '80)	2,310.2	+ 12.5	+ 9.0

† Seasonally adjusted.

* Seasonally adjusted annual rate.

‡ Four-week moving average.

New York Money Market

Offering Rates 1/9/81

	3 Months	6 Months	1 Year
U.S. Treasury Bills	15.00%	14.22%	12.62%
Federal Agencies	16.38	15.13	13.07
Project Notes—Taxfree (46% Taxable Equivalent)	11.57	13.15	13.15
Negotiable Time CDs			
Manufacturers Hanover	Rates By Arrangement		
Secondary Market—Prime	15.50	14.00	
Finance Company Paper—Prime			
5- 14 days	17.00%		
15- 29 days	18.00		
30- 59 days	17.50		
60-179 days	16.00		
180-270 days	13.50		
Bankers' Acceptances			
Feb.			17.80%
Mar.			17.20
Apr.			16.40
May			16.00
Jun.			15.50
Jul.			14.70

Industrial Paper—Prime

30- 89 days	17.88%	Federal Funds	
90-120 days	16.50	Effective Rate	19.70%

‡ Discount basis.

* Subject to availability.

† Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'80	\$ 2,637	\$ 2,565	\$ 2,444
Gross National Product (1972 Dollars)*	3rd Q'80	\$ 1,472	\$ 1,463	\$ 1,488
Percent Change, Annual Rate	3rd Q'80	2.4%	- 9.9%	4.1%
Change in Consumer Prices (all urban consumers)*	Nov '80	12.0%	12.0%	12.0%
Change in Producer Prices*	Dec '80n	7.2%	7.2%	9.6%
Civilian Employment (Thousands of Persons)†	Dec '80n	97,280	97,339	97,912
Unemployment as % of Civilian Labor Force†	Dec '80n	7.4%	7.5%	5.9%
Personal Income*	Nov '80	\$ 2,257	\$ 2,233	\$ 2,006
Leading Indicators Composite Index (1967=100)†	Nov '80	137.6	136.0	135.6
Industrial Production Index (1967=100)†	Nov '80	148.5	146.5	152.3
Net Change in Consumer Installment Credit†	Oct '80	\$ 1.46	\$ 1.45	\$ 2.19
U.S. Merchandise Trade Balance†	Nov '80n	-\$ 0.79	-\$ 0.97	-\$ 1.62
Plant and Equipment Expenditures*	1st Q'81	\$310.59(a)	\$297.30(a)	\$291.89
Private Housing Starts (Thousands of Units)*	Nov '80	1,555	1,561	1,522
New Construction Expenditures*	Nov '80	\$ 231.8	\$ 225.0	\$ 239.4
Total Business Inventories†	Oct '80	\$ 457.3	\$ 454.6	\$ 422.7
Total Business Sales†	Oct '80	\$ 325.5	\$ 318.3	\$ 298.5

* Seasonally adjusted annual rate.

† Seasonally adjusted.

n-Newly reported figure.

a-Anticipated.

one of the largest sectors of our economy, it is noted that it does not have the same influence it once had. Sales of domestic cars have not expanded at the same pace as the real GNP. In fact, while unit auto sales increased by 27 per cent during the 15 years ending in 1978, GNP grew almost three times as fast.

Prospects For The Dollar . . .

The exchange rate of the U.S. dollar against the other major currencies continues to reflect mainly interest rate differentials. Although the relationship between changes in exchange rates and interest rates is not fixed, the dollar exchange rate in the last 12

months has shown a strong tendency to move in the same direction as domestic and Eurodollar rates.

In spite of the poor performance of the U.S. economy in 1980, the dollar showed strength against most other major currencies. Between the first and last trading days of 1980, the dollar appreciated by over 12 per cent against the German mark, 11 per cent against the French franc and 11 per cent against the Swiss franc. On the other hand, the British pound appreciated by seven per cent against the dollar (reflecting a high interest rate policy in that country), while the Japanese yen appreciated about 18 per cent against the dollar. The rise in the

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since	
		Week Ago	Year Ago
Negotiable Time CD's			
Weekly Reporting Banks			
Nationwide (12/24/80)	115,517	+ 4,190	+22,936
New York City (12/24/80)	28,497	+ 1,040	+ 8,282
Commercial Paper (12/24/80)	123,193	- 1,730	+10,868

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans			
Weekly Reporting		Latest	Change Since
Large Commercial Banks		Week	Week Ago Year Ago
Nationwide (12/24/80)		172,514	- 1,545 +15,717
New York City (12/24/80)		50,679	- 1,222 + 3,536
Total Loans Gross Adjusted			
		Latest	Change Since
		Week	Week Ago Year Ago
Nationwide (12/24/80)		428,428	+ 842 +31,630
New York City (12/24/80)		101,230	- 341 +10,582

Financial Markets

	Friday 1/9/81	Change Since	
		Week Ago	Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	16.00%	+ 1.04	+ 3.76
180-Day Bills†	15.60	+ .67	+ 2.98
Longest Bills†	14.28	+ .45	+ 2.44
Recent Issues:			
15 ¹ / ₈ s 12/31/82	13.52	+ .52	
14s 12/31/84	13.00	+ .35	
13s 11/15/90	12.54	+ .16	
12 ³ / ₄ s 11/15/10	12.09	+ .16	
Municipals:			
Bond Buyer—20 Bond Index* (1/8/81)	9.49%	- .27	+ 2.19
Blue List Total (\$ Million)	\$ 606	+ \$ 53	- \$ 257
30-Day Visible Supply (\$ Million)	\$ 882	+ \$ 32	- \$ 664
Total	\$1,488	+ \$ 85	- \$ 921
Corporates:			
Moody's Aa Composite (1/8/81)	13.35%	+ .21	+ 1.95
Money Mgr.—30-Day Supply (\$ Million)	\$3,692	+ \$222	+ \$2,298
Stocks:			
Dow-Jones Averages:			
Industrials	968.69	- 4.09	+ 110.16
Transportation	384.82	- 16.61	+ 127.81
Utilities	112.89	- 2.23	+ 3.72
65 Stocks	369.77	- 6.81	+ 64.83
Standard and Poor's 500 Stocks	133.48	- 2.05	+ 23.56
N.Y.S.E. Composite Index	76.44	- 1.82	+ 13.11
N.Y.S.E. Avg. Daily Vol. for Week (000's)	65,134	+25,723	+ 10,638

* 46% Taxable equivalent 17.57%.

† Bond equivalent.

International Rates

	Friday 1/9/81	Week Ago
EURODOLLAR DEPOSIT RATES (bid)		
Overnight	19.88%	19.88%
1 month	19.00	19.13
3 month	18.00	18.00
6 month	16.63	16.88
1 year	15.38	15.06
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	12.90%	12.60%
Long Term (7 to 15 yrs.)	12.80	12.80
FOREIGN EXCHANGE SPOT RATES		
New York Opening	U.S. \$	Currency
(1/9/81)	Equivalent	Per U.S. \$
Belgium	.03157	31.68
Canada	.8420	1.1876
Denmark	.1648	6.0680
France	.2199	4.5480
Germany	.5084	1.9670
Italy	.001069	935.25
Japan	.004943	202.30
Mexico	.04290	23.31
Netherlands	.4677	2.1380
Switzerland	.5622	1.7787
U.K.	2.4015	.4164

yen in 1980 mirrored, among other things, the strength of the Japanese economy (which grew about five per cent) and large inflows of funds from the Middle East, as the OPEC nations diversified their investment portfolios.

Since the first of the year, as U.S. and Eurodollar interest rates have begun to decline, the dollar has begun to weaken as well. This weakness also reflects uncertainty about U.S. economic policy under the new Administration. Response to small changes in interest rates has been correspondingly exaggerated in the foreign exchange markets as investors seek to pierce the curtain of the future. It is probable that the present instability in the foreign exchange markets will fade over the next few months and give way to a period of relative stability. Although the U.S. is anticipating another year of low growth and a high though slowing rate of inflation, the factors which shape the foreign exchange markets will continue to operate in the dollar's favor in most respects.

... Still Look Good

At present, all of the important exchange rate factors favor the dollar. Interest rates, though falling, are still high relative to most other major countries, and although the inflation rate is also still high, it appears to be declining under the impact of low growth and a tight Fed monetary policy. Hence real interest rates still make dollar assets desirable and will probably continue to do so during 1981. At present, three-month Eurodollar rates are close to 18.0 per cent with inflation in the U.S. currently running at about 12 per cent yielding a "real" interest rate of six per cent. Three-month Euro-marks are approximately nine per cent with inflation currently about 5.2 per cent yielding a 3.8 per cent real interest rate.

The real interest rate differential has narrowed in recent weeks yet still remains favorable to holders of dollar denominated assets. The question in the minds of foreign exchange traders and international money managers is whether or not the recent break in interest rates represents the beginning of a substantial decline or is merely a brief hiatus in a period of sustained high real interest rates.

The longer-run outlook is even more favorable to a strong dollar. Most balance of payments analysts believe that the U.S. ended 1980 with a modest current account surplus. At the same time, Germany probably experienced a current account deficit of close to \$16 billion and most other major nations also expected large deficits (largely due to rising oil prices and declining export opportunities).

In 1981 the U.S. current account should show a substantial surplus. Low real growth in the United States will reduce import demand while many of our

exports, particularly agricultural products, are expected to do well. Oil imports, the major contributor to U.S. trade deficits, are expected to decline as economic activity slows and as the de-regulation of domestic oil prices and gradually rising OPEC prices continue to discourage consumption.

Given these considerations, it is probable that the dollar will continue to retain most of its recent strength as long as the favorable interest rate spread exists—that is, until interest rates decline to the point where our higher inflation rate erases the advantage. In the medium term, a lower level of strength will reside in the dollar as long as our current account performance exceeds that of the other principal countries. In the event that the real interest rate advantage disappears, but the current account picture remains favorable, the dollar exchange rate will continue to enjoy a very modest but noticeable level above the rates prevailing in late 1978 and early 1979 (when the U.S. current account was in deficit).

H

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